According to modern economic theories, people with indistinguishable talents will obtain equal remuneration in a wholly integrated labour market (Hicks, 1963; Marhsall, 1920). Adhering to the same premise: many studies have tested for wage convergence in the context of broader labour market analysis, taking labour as a factor of production (Galizia, 2015; Rosenbloom, 1998; Rosenbloom & Sundstrom, 2002). Given the unrestricted mobility of people (in addition to lower transportation costs and the use of a common currency), testing wage convergence as the price of labour within a country is more reasonable than across countries. While wage convergence is generally expected, the absence of convergence at the intra-national level implies the presence of regional imbalances, resource misallocation, and differences in the cost of living (González, 2020).

In Indonesia, analysing wage convergence is relevant because it often becomes the main factor for many people to migrate. Based on theory, the economic reason is one aspect that could influence migration, and several approaches that underlie this among them were delivered by Mantra (1992) and Todaro & Smith, (2003). Both agree that economic motives are reasons for migration, especially migration from rural to urban areas. Moreover, there has been improvements in people’s mobility due to rapid development of transportation infrastructure in Indonesia in the last decade. Interestingly, however, despite the advancing people’s mobility, the trend of regional wage disparity in Indonesia is persistent. This pattern is different from that in China and India, the other two developing and most populated countries in Asia which exhibit a declining trend of regional wage dispersion during the same period. This observation adds relevance to the study of regional wage convergence in Indonesia.

Against this backdrop, the present study focuses on convergence patterns of the long-run dynamics in wages across Indonesian provinces and the influencing factors of converging behaviour. Specifically, we address two crucial questions in the empirical analysis. First, can we identify club convergence in regional wages in Indonesia, despite the presence of prolonged wage disparity? Second, to what extent do region-specific characteristics influence club convergence? To achieve these goals, we divide our strategy into two main steps. First, we test whether regional wages converge to a common steady-state using log t regression developed by Phillips & Sul (2007, 2009). Second, we investigate the essential factors that influence club convergence formation using ordered logit model. We use the average net income per month of employees and labourers in 34 provinces from 2008 to 2020 as the primary indicator instead of the regional minimum wage (Upah Minimum Regional - UMR) to represent the real market situation. We also convert the data from nominal to real terms.

Our results from the first step show three significant clubs representing the convergence dynamics of regional wage across Indonesian provinces: three provinces clustered in club 1, nine provinces in club 2, and 22 provinces in club 3. Overall, the results from our initial investigation imply that, based on the long-run dynamics of regional real wages from 2008 to 2020, Indonesian provinces can be clustered into three club convergences. The presence of club convergence from our results is similar to the finding of Neagu (2020) in the context of regional wage analysis in Romania.

In the second part, the results from the ordered logit model show that regional characteristics related to labour market conditions largely explain the formation of club convergence in provincial wages. Variables such as manufacturing employment share, investment-to-GDP ratio, labour force participation, and the initial condition of wage significantly influence the convergence club formation, while the size of the economy, or GDP, exhibit insignificant effects. Our findings are compatible with the theoretical underpinnings of the convergence concept and comparable to previous club convergence investigations (Bartkowska & Riedl, 2012; Cutrini, 2019; Von Lyncker & Thoennessen, 2017).

Taken together, our results suggest four key points concerning policy implications for reducing wage disparity across Indonesian provinces. First, it is imperative to promote the development of manufacturing industries in all provinces. Manufacturing sectors would attract skilled workers from different places and bring positive technical spillovers to local workers. In turn, this would create a trickle-down effect that tends to help reduce wage disparity, as in the case of India (Jain, 2018). Second, boosting investment is equally important, not to mention attracting inward FDI. Technology spillovers and demand creation effects brought by FDI firms would positively influence the productivity of local firms and workers, leading to improved wage levels. Third, reducing wage differentials across regions requires convergence in education. Therefore, improving education quality in less developed regions should become a priority and promote industrialisation and investment to guarantee the provision of educated labour and skilled workers. Finally, the Indonesian government needs, both national and local, to continue enhancing healthy competition in the regional labour market to promote efficiency in resource allocation across regions.